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THE INCOME TAX ACT (CHAPTER 470 – LAWS OF KENYA).

An Act of Parliament to make provision for the charge, assessment and collection of income tax and for the ascertainment of the income to be charged.¹

PROVISIONS RELATING TO INCOME CHARGEABLE TO TAX

SECTION 3(2)

Subject to this Act, income upon which tax is chargeable under this Act is income in respect of –

(a) gains or profits from –

- (i) a business, for whatever period of time carried on;*
- (ii) employment or services rendered;*
- (iii) a right granted to another person for use or occupation of property;*

(b) dividends or interest

(c) pension, charge or annuity

(d) an amount deemed to be the income of a person under this Act or by rules made under this Act;

(e) gains accruing in the circumstances prescribed in, and computed in accordance with, the EIGHTH SCHEDULE.

Nonetheless the Minister of Finance has wide discretion under Section 13(2) to grant exemptions to income that would otherwise be chargeable to tax.

SECTION 13(2)

The Minister may, by notice in the Gazette, provide –

- (a) that income or a class of income which accrued in or was derived from Kenya shall be exempt from tax to the extent specified in the notice.*
- (b) that an exemption under subsection (1) shall cease to have effect either generally or to the extent specified in the notice.*

PROVISIONS RELATING TO TAX EXEMPTION

Even though donations are not identified under section 3(2) as income subject to taxation, NPOs have to apply for tax exemption of their incomes, which mainly consist of donor funds.

SECTION 13(1)

Notwithstanding anything in PART I of the FIRST SCHEDULE income which accrued in or was derived from Kenya shall be exempt from tax to the extent so specified.

FIRST SCHEDULE, PART I – INCOME ACCRUED IN, DERIVED FROM OR RECEIVED IN KENYA WHICH IS EXEMPT FROM TAX

¹ See preamble to Chapter 470, Laws of Kenya.

Tax Exempt Organizations

2. *The income of a person who, or organization which, is exempt from income tax by or under any Act for the time being in force, to the extent provided by that Act.*

1. 10. *Subject to section 26, the income of an institution, body of persons, or irrevocable trust, of a public character² established solely for the purposes of the relief of the poverty or distress of the public, or for the advancement of religion or education,*
 - *established in Kenya;³ or*
 - *whose regional headquarters is situated in Kenya,⁴ in so far as the Commissioner is satisfied that the income is to be expended either within Kenya or in circumstances in which the expenditure of that income is for purposes which result to the benefit of the residents of Kenya.⁵*

BUSINESS ACTIVITIES BY CHARITIES AND INCOME TAX EXEMPTION

Schedule 1 (10) distinguishes between related and unrelated activities.

:

Income derived directly from business activities which are carried out by charities, may be exempted from taxation only if:

- the income is applied to the limited purposes set out in Schedule I or
- the business activities are directly related to the limited purposes set out in Schedule I.

Provided that any such income which consists of gains or profits from a business shall not be exempt from tax unless those gains or profits are applied solely to those purposes and either-

- (i) *the business is carried on in the course of the actual execution of these purposes;⁶ or*
- (ii) *the work in connexion with the business is mainly carried on by beneficiaries under those purposes;⁷ or*
- (iii) *the gains or profits consist of rents (including premiums of similar consideration in the nature of rent,) received from the leasing or letting of land and chattels leased or let therewith.*

² These must be of a public character (not membership institutions like clubs). They must be open and without barriers.

³ Section 53 of the Finance Act of 2001 included this as an amendment.

⁴ Id

⁵ See also Legal Notice No.68 of 10th June 1999 for the definition of a charitable organization under the VAT Act.

⁶ That is, business, the conduct of which contributes to the accomplishment of the exempt purposes of the charitable organization. For example, an educational charity running a school.

⁷ For example, a charity set up to provide work for the disabled.

PROVISIONS RELATING TO ALLOWABLE DEDUCTIONS FROM TAXABLE INCOME

SECTION 15(1)

For the purpose of ascertaining the total income of a person for a year of income there shall, subject to SECTION 16 (deductions that are disallowed), be deducted all expenditure incurred in that year of income which is expenditure wholly and exclusively incurred by him in the production of that income.

CONTRIBUTIONS BY BUSINESSES

Under SECTION 15(2), deductions are allowed for expenditure directly incurred by a business entity from related business activities. These include *inter alia*,

- (n) expenditure incurred by a person for the purposes of a business carried on by him being-*
 - (iii) a sum paid to a scientific research association approved for the purposes of this paragraph by the Commissioner as being an association which has as its object the undertaking of scientific research related to the class of business to which the business belongs; or*
 - (iv) a sum paid to a university, college, research institute or other similar institution approved for the purposes of this paragraph by the Commissioner for the scientific research mentioned in subparagraph (iii);*
- (6) For the purposes of this section –*
 - (a) “scientific research” means activities in the fields of natural or applied science for the extension of human knowledge, and when applied to any particular business includes –*
 - (i) scientific research which may lead to, or facilitate, an extension of that business or of businesses in that class;*
 - (ii) scientific research of a medical nature which has a special relation to the welfare of workers employed in that business, or in businesses of that class;*

Section 15(2)(p):

(p) expenditure on advertising in connexion with a business to the extent that the Commissioner considers just and reasonable is a deductible expense.

...and for this purpose “expenditure on advertising” includes expenditure intended to advertise or promote, whether directly or indirectly, the sale of the goods or services provided by that business.

TAX PROVISIONS UNDER THE CUSTOMS AND EXCISE ACT AND THE VAT ACT RELATING TO NPOS

Under the Customs and Excise Act and the Value Added Tax (VAT) Acts, NGOs wishing to obtain exemption or remission from Import Duty and VAT respectively, must

in the first place be exempt organizations under the Income Tax Act. The exemption is limited to 50 per cent of duty or tax payable. Prior to June 1999, NGOs enjoyed 100 per cent remission or exemption from duty or tax payable.

THE CUSTOMS AND EXCISE ACT, CHAPTER 472, LAWS OF KENYA

*An Act of Parliament to provide for the management and administration of the customs, for the assessment, charge and collection of customs and excise duties.*⁸

SECTION 138(1)

The Minister may, by order in the Gazette, remit in whole or in part or in whole any import duty, suspended duty or dumping duty payable by any person on goods, aircraft, vessels or vehicles imported by that person, if he is satisfied that it is in the public interest to do so.

Though the Minister enjoys wide discretion under the provision, his powers of exemption are qualified by SECTION 138(2), which provides that;

Remission under subsection (1) shall only be in respect of—

(c) such other goods, including motor vehicles and computers, excluding passenger motor vehicles of an engine capacity exceeding 3000cc and four-wheel drive passenger motor vehicles of an engine capacity exceeding 4000cc, building materials, office equipment, stationery, office furniture, textiles, new and used clothing, footwear, maize, wheat, sugar, milk and rice donated or purchased for donation by any person to non-profit making organizations or institutions approved by the Government, for their official use or for free distribution to poor and needy persons, or for use in medical treatment, educational, religious or rehabilitation work or for other Government approved projects:

Provided that where maize, wheat, sugar, milk, edible vegetable fat and oils, rice, textiles, new and used clothing and footwear are imported during periods of civil strife, national calamity or disaster declared under any law for the time being in force, or where they are intended for use in officially recognised refugee camps in Kenya, duty in respect thereof may be remitted under this section.

⁸ See Preamble, Chapter 472, Laws of Kenya.

Not only does this provision (c) limit the type of goods that can be subject to remission under section 138(1), but it also restricts the use to which such goods can be put, that is, to charitable uses. The remission is primarily intended to serve the public interest.

PROVISIONS RELATING TO EXEMPTIONS

Legal Notice No.68 of 10th June 1999 defines the person who can seek tax or duty exemption under the Customs and Excise Act as a charitable organization.

- (i) *“Charitable organization” is a non profit making organization registered as such, or which is exempted from registration, by the Registrar of Societies under section 10 of the Societies Act or by the Non-Governmental Organizations Co-ordination Board under section 10 of the Non-Governmental Organizations Co-ordination Act, 1990; and*
- (ii) *whose income is exempt from tax under paragraph 10 of the First Schedule to the Income Tax Act. (This latter part of the provision implies that the entities seeking exemption must satisfy the Commissioner of Income Tax that they are established for charitable purposes only).*

The VAT Act also adopts this definition of a charitable organization.

Under THE THIRD SCHEDULE, PART A (12) of the Customs and Excise Act, the Commissioner has the power to grant a remission to charitable organizations on,

(1) Goods, being bona fide gifts (excluding office equipment, stationery and office furniture)-

- (a) *which the Commissioner is satisfied are imported by or consigned to charitable organizations registered as such, or which are exempted from registration, by the Registrar of Societies under section 10 of the Societies Act or by the Non-Governmental Organizations Co-ordination Board under section 10 of the Non-Governmental Organizations Co-ordination Act, 1990 and whose income is exempt from tax under paragraph 10 of the First Schedule to the Income Tax Act, and approved by the Commissioner of Social Services for free distribution to poor and needy persons or for use in medical*

treatment or rehabilitation work in their institutions provided that the Treasury has given its approval in writing where the duty exceeds Ksh. 40,000;

(b) consigned to or imported by any organization if the Commissioner is satisfied that they are for free donation to charitable organizations registered as such, or which are exempted from registration, by the Registrar of Societies under section 10 of the Societies Act or by the Non-Governmental Organizations Co-ordination Board under section 10 of the Non-Governmental Organizations Co-ordination Act, 1990 and whose income is exempt from tax under paragraph 10 of the First Schedule to the Income Tax Act, and approved by the Commissioner of Social Services for free distribution to poor and needy persons or for use in medical treatment or rehabilitation work in their institutions provided that the Treasury has given its approval in writing where the duty exceeds Ksh. 40,000;

(c) including equipment, motor vehicles, vessels and aircraft (excluding passenger motor vehicles of an engine capacity exceeding 3000 cc and four-wheel drive passenger motor vehicles of an engine capacity exceeding 4000cc) consigned to or imported by any organization, if the Commissioner is satisfied that they are for free donation to charitable organizations –

i. registered as such, or which are exempted from registration, by the Registrar of Societies under section 10 of the Societies Act or by the Non-Governmental Organizations Co-ordination Board under section 10 of the Non-Governmental Organizations Co-ordination Act, 1990; and

ii. whose income is exempt from tax under paragraph 10 of the First Schedule to the Income Tax Act,

and are approved by the Commissioner of Social Services for use by charitable organizations in medical treatment, educational, religious or rehabilitation work, subject to the written approval of the Treasury where the duty exceeds 100, 000 shillings; and the Commissioner shall make quarterly returns of all exemptions granted under this paragraph.

THE VALUE ADDED TAX ACT, CHAPTER 476, LAWS OF KENYA

An Act of Parliament to impose a tax to be known as value added tax on goods delivered in, or imported into Kenya; and on certain services supplied in Kenya and for connected purposes.⁹

Remission under the VAT Act covers goods donated to, consigned to or imported by charitable organizations. Services provided by charitable organizations are also granted

⁹ See preamble, Chapter 476, Laws of Kenya.

remission under this Act. It should be noted, nonetheless, that Legal Notice No.68 of 10th June 1999 provides, “Tax shall become payable if the goods which are the subject of the order are used or disposed of in a manner inconsistent with the purpose for which the remission is granted”. Hence, as in the Customs and Excise act, remission or exemption is limited to particular goods, purchased by particular organizations and to be applied to determinate uses;

Under section 23(3) and paragraph 9(1) of the 8th Schedule, goods imported by or consigned or donated to charitable organizations may receive exemption where the Commissioner is satisfied that the items are:

- for free distribution to poor and needy persons,
- for use in medical treatment, educational or religious work
- for rehabilitation work in charitable institutions
- or for other Government approved projects.

The Commissioner’s judgement of what is in the public’s interest is tempered by the criteria stipulated under VAT Act. Similar criteria are adopted in the Customs and Excise Act.

Section 23(1)

Subject to subsection (3), the Minister may, by order in the Gazette, remit wholly or partly tax payable in respect of any taxable supply or class of taxable supplies, if he is satisfied that it is in the public interest to do so.

This provision allows the Minister to remit VAT but under certain limits specified in section 23(3).

Section 23(3)

Remission under subsection (1) shall not apply to a taxable person, and shall only apply in respect of –

- (iii) *such other goods, including motor vehicles and computers excluding passenger motor vehicles of an engine capacity exceeding 3000 cc or four-wheel drive passenger motor vehicles of a sitting capacity of up to twenty-six persons, building materials, audio and audiovisual electronic equipment, spare parts, edible vegetable fats and oils, office furniture and other office equipment, stationery, textiles, new and used clothing and footwear, maize, wheat, milk and rice, donated or*

purchased for donation by any person¹⁰ to non-profit making organizations or institutions approved by the Government for their official use or for free distribution to the poor and needy persons, or for use in medical treatment, educational, religious or rehabilitation work or other Government approved projects.

Provided that

- (iv) *remission granted under this paragraph shall not exceed 50% of the tax payable.*

“remission under this paragraph may be granted where maize, wheat, sugar, milk, edible vegetable fats and oils, rice, textiles, new and used clothing and footwear are imported or purchased locally during periods of civil strife, national calamity or disaster declared under any law for the time being in force or where they are intended for use in officially recognised refugee camps in Kenya”.

Recently, during the budget speech for the 2001/2002 fiscal year, the Minister of Finance made certain proposals that were later incorporated as amendments to the VAT Act. Under Section 23(3), remission is now granted with respect to:

‘projects funded through donations by any person –

- (i) *and approved by the Government for the provision of medical treatment, educational, religious or rehabilitation services or any other services; or*
- (ii) *to non-profit making organisations or other institutions approved by the government for their official use or for the benefit of poor and needy persons.¹¹*

EIGHTH SCHEDULE

PART A – Public Bodies, Privileged Persons and Institutions with zero-rated status on imports and purchases.

Taxable goods shall be zero-rated when imported or purchased before clearance through the customs or purchased before the imposition of tax by or on behalf of the following public bodies, privileged persons and institutions subject to the limitations specified in this Schedule:

¹⁰ Any person can be an NPO purchasing to donate to another NPO

¹¹ See Section 32 of the Finance Act of 2001.

9. *Charitable Institutions*

(1) *Goods being bona fide gifts –*

- (a) *which the Commissioner is satisfied are imported by or consigned to charitable organizations registered as such, or which are exempted from registration, by the Registrar of Societies under section 10 of the Societies Act or by the Non-Governmental Organizations Co-ordination Board under section 10 of the Non-Governmental Organizations Co-ordination Act, 1990 and whose income is exempt from tax under paragraph 10 of the First Schedule to the Income Tax Act, and approved by the Commissioner of Social Services for free distribution to poor and needy persons or for use in medical treatment or rehabilitation work in charitable institutions provided that the Treasury has given its approval in writing where the tax would exceed Ksh. 500,000;¹²*
- (b) *consigned to or imported by any organization if the Commissioner is satisfied that they are for free donation to charitable organizations registered as such, or which are exempted from registration, by the Registrar of Societies under section 10 of the Societies Act or by the Non-Governmental Organizations Co-ordination Board under section 10 of the Non-Governmental Organizations Co-ordination Act, 1990 and whose income is exempt from tax under paragraph 10 of the First Schedule to the Income Tax Act, and approved by the Commissioner of Social Services for free distribution to poor and needy persons or for use in medical treatment or rehabilitation work in charitable institutions provided that the Treasury has given its approval in writing where the tax would exceed Ksh. 500,000;¹³*
- (c) *including equipment, motor vehicles, vessels and aircraft (excluding passenger motor vehicles of a seating capacity of up to twenty-six persons, vessels and aircraft, consigned to or imported by any organization, if the Commissioner is satisfied that they are for free donation to charitable organizations registered as such, or which are exempted from registration, by the Registrar of Societies under section 10 of the Societies Act or by the Non-Governmental Organizations Co-ordination Board under section 10 of the Non-Governmental Organizations Co-ordination Act, 1990; and whose income is exempt from tax under paragraph 10 of the First Schedule to the Income Tax Act; and approved by the Commissioner of Social Services for use by the charitable organizations in medical treatment, educational,*

¹² This paragraph covers direct purchases by non-profit organizations of goods, with the exception of equipment and motor vehicles.

¹³ This paragraph covers donations by any person to non-profit organizations of the goods covered in paragraph 9(1)(a).

religious or rehabilitation work provided that the Treasury has given its approval in writing where the tax would exceed Ksh. 40,000;¹⁴

(6) Zero-rating under item 9 (1) (c) shall be limited to 50% of the tax payable.

EXEMPT SERVICES;

The THIRD SCHEDULE of the VAT Act exempts a wide range of public benefit services from VAT. Paragraphs 16 and 18 were recently inserted in the Schedule through the Finance Act of 2001, Schedule V. These gradual changes to the tax laws in Kenya have, without a doubt, had significant beneficial impact on the NPO sector.

The following services shall be exempt services for the purposes of the Act

7.Social welfare services provided by charitable organizations registered as such, or which are exempted from registration, by the Registrar of Societies under section 10 of the Societies Act, or by the Non-Governmental Organizations Co-ordination Board under section 10 of the Non-Governmental Organizations Co-ordination Board Act, 1990 and whose income is exempt from tax under par. 10 of the First Schedule to the Income Tax Act and approved by the Commissioner of Social Services.

16. Services rendered by –

(a) trade, professional and labour associations;

(b) educational, political, religious, welfare and other philanthropic associations to their members:

Provided that this paragraph shall not apply where any such services are rendered by way of business.

The following entertainment services –

(c) entertainment of a charitable, educational, medical, scientific or cultural nature as may be approved in writing by the Commissioner prior to the date of entertainment for the benefit of the public; or

(c) entertainment organized by a non-profit making charitable, educational, medical, scientific or cultural society registered under the Societies Act where entertainment is in furtherance of the objects of society as may be approved in writing by the Commissioner prior to the date of the entertainment.

18.Accomodation and restaurant services provided within the following premises:

(a) establishments operated by charitable or religious organizations registered under the Societies Act for charitable or religious purposes; or

¹⁴ This paragraph includes donations of equipment and vehicles. Vehicles or equipment directly purchased by charitable organizations either with their own funds or donated funds are not included.

(b) establishments operated by an educational training institution approved by the Minister for the use of staff and students of that institution,

(c) establishments operated by a medical institution approved by the Minister for the time being responsible for health for the use by the staff and patients of such institutions.¹⁵

THE NON-GOVERNMENTAL CO-ORDINATION ACT (ACT. NO. 19 OF 1990)

The Kenyan NGO law is an attempt to codify the law of trusts or charities known to English law.¹⁶ However, the NGO Coordination Act deals with only a few of the issues relating to charities, while addressing a wide range of other matters. Section 2 of the Act reveals this wide reach in approach.

SECTION 2:

“Non-Governmental Organization” means a private voluntary grouping of individuals or associations, not operated for profit or for other commercial purposes but which have organized themselves nationally or internationally, for the promotion of social welfare, development, charity or research through mobilisation of resources.

SECTION 12(3)

A registered NGO shall by virtue of such registration be a body corporate capable in the name of—

- (a) suing and being sued;*
- (b) taking, purchasing or otherwise acquiring, holding, charging or disposing of movable and immovable property;*
- (c) entering into contracts; and*
- (d) doing or performing all other things or acts necessary for the proper performance of its functions under this Act, which may lawfully be done or performed by a body corporate.*

Hence, where NGOs conduct a trade or business that is not related to and in furtherance of the not-for-profit purposes of the organization, their net profits, as those of any corporate, will be subjected to income tax.

SECTION 20

An organization established by a state or a group of states for welfare, research, relief, public health or other forms of development assistance shall not be eligible for registration under this Act.

¹⁵ The VAT Act is amended by repealing the Third Schedule and replacing it with a new Third Schedule as set out in the Fifth Schedule of the Finance Act.

¹⁶ Bernard Sihanya ‘Regulatory regimes Governing NGOs in Kenya’ op. cit.p.12.

PART VII – MISCELLANEOUS PROVISIONS

SECTION 32

The Minister may make rules for the efficient carrying into effect of the provisions of this Act and, without restricting the generality of the foregoing, make rules –

(g) prescribing procedures for application for exemption from payment of taxes.